RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Feb. 16, 1994 **LETTER 1141**

THE PICTURE: Question: Russell, what was the meaning of the big 96 point Dow break on February 4? Is a bear market on the way, or was that just a correction? And what about the Fed's action on interest rates?

Answer: The stock market put on a heck of a performance during January. In fact, that performance, together with the public's three-year mass migration into mutual funds, probably worried (or I should say frightened) the Fed. Thus the Fed decided to give the stock market a little "pin prick." That prick, of course, was the 0.25% boost in the Fed Funds. It was the Fed's way of saying, "Cool it, please, we don't want to follow the Japanese example -- first a giant stock market bubble and then a collapse."

Question: So you think the Fed was worried about the stock market as well as inflation? OK, then what happens if, over the next month or so, the stock market advances to new highs?

Answer: I think the market action of the last few months worried the Fed, but I think the Fed was also worried by the rise in gold and the sharp advance in commodity indices. So the Fed had a number of reasons for that little rate boost. And yes, if the market quickly advances to new highs, it would not surprise me to see another 0.25% boost in Fed Funds.

Question: Then what about that 96 point Dow break of February 4? What was the market telling us?

Answer: So far, the market hasn't told us anything definite. But one thing the sell-off did accomplish is that it provided upside points for Dow Theorists to watch. Please read the opening paragraphs of the last Letter again. In it I said that when the market is in its third phase (i.e., high volume, overvaluation, heavy public participation), then every decline must be taken seriously.

Why? Because following a decline, if the two Averages, D-J Industrials and Transports, can rally to NEW HIGHS, the primary bull trend will be reconfirmed -- and then, no problem. However, if one or both of the Averages fail to advance to new highs, the implication is that the primary trend could be in the process of turning down. (I will discuss the pattern of an actual Dow Theory bear signal in a later Letter.)

The critical upside points for the market are as follows: D-J Industrials **3978.36;** D-J Transports **1862.29. Please write those numbers down.** Those are the points, which, if surpassed, will reconfirm the bull market. If not -- trouble.

Question: How much time should we give the Averages as far as their ability to advance to new highs?

Answer: There is no time limit. They can take a week, a month, three months or longer. However, the LONGER the time elapsed without new highs, the greater the suspicion that we are not going to see new highs.

Question: So Russell, as things stand you really can't say whether the primary trend of the market is still bullish -- or whether a bear market has started.

Answer: That is correct. If you could know the answer to that one for certain, you'd be on your way to becoming the richest man in the land. This is the area where only the liars and con-men offer

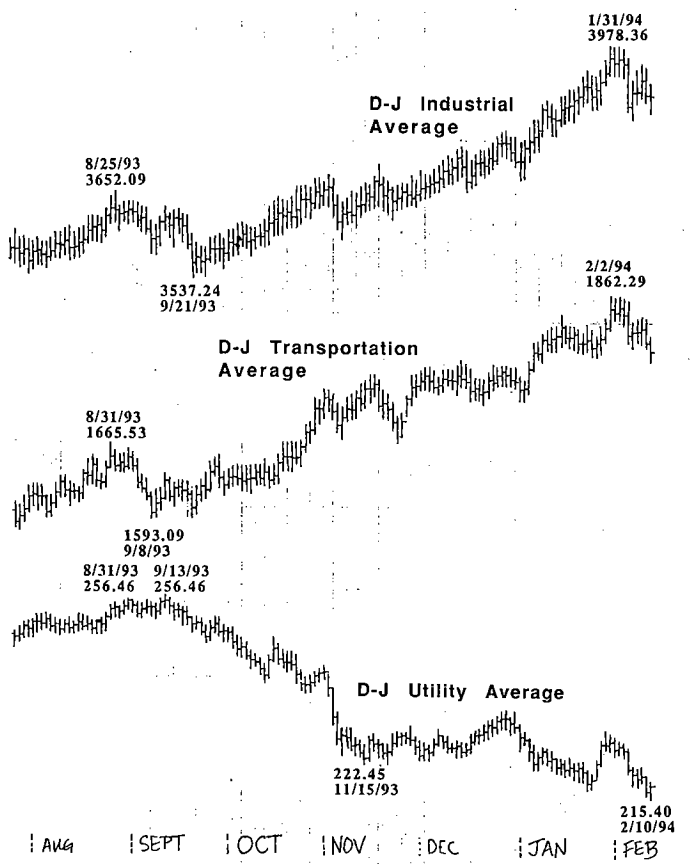
Feb. 4 DJIA 3871.42; PTI 4088; A-D Ratio -1.91
Feb. 11 DJIA 3894.78; PTI 4085; A-D Ratio -2.05
Dow Yield: 2.58%; Dow Price/Earnings: 26.0
Dow 200-day MA: 3639; Dow 30-day MA: 3883
Dow Times Book Value: 3.39; PTI 89-day MA: 4027
Percentage of Undervalued Blue-chips: 7%
Dow Low Risk Buy Index: +113; Gold-PTI: 1043
Gold 40-week MA: 376

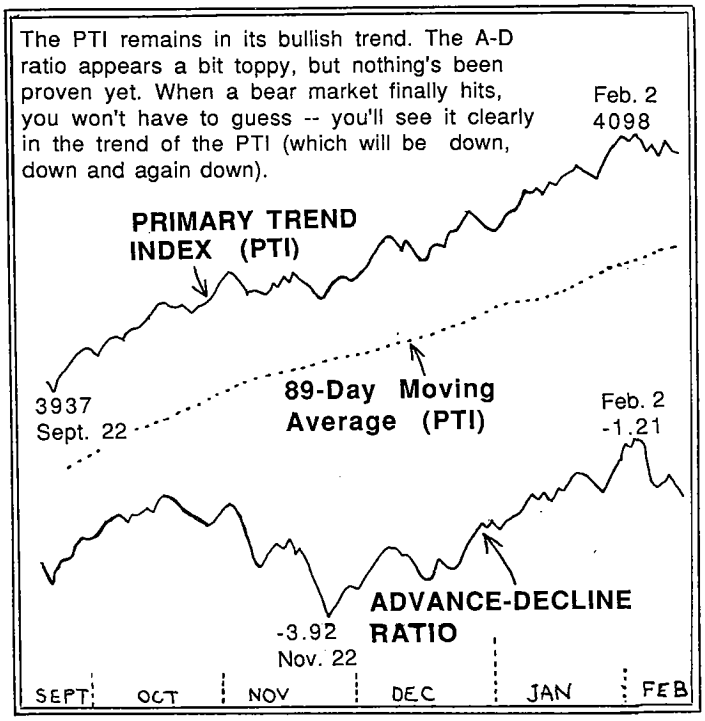
certainty. Following a big market break which comes in the third phase of a bull market, wise men wait for the market itself to do the "talking." There is, however, one Dow Theory rule we can fall back on. It states that the trend is taken to remain in force until proved otherwise. At this writing we have no "otherwise" proof, so we take the market as remaining bullish.

Question: Russell, you say that this market is in its third phase. Please explain.

Answer: Every bull market has three phases. The phases have to do with market sentiment, rather than price movement. The third phase of a bull market is characterized by high volume, low yields, great optimism, heavy public participation, many new offerings and many secondaries, and a general feeling that "the bull market will continue, no matter what," that despite overvaluation and despite all other bearish considerations "this time it's different."

The reason it is important to recognize or identify the third phase is that this is the phase in which the bull will ultimately die. And this is the phase where secondary reactions are most important, since any secondary may conceivably be the start of something bigger -- a primary bear market.




The PTI remains in its bullish trend. The A-D ratio appears a bit toppy, but nothing's been proven yet. When a bear market finally hits, you won't have to guess -- you'll see it clearly in the trend of the PTI (which will be down, down and again down).
Feb. 2
4098
PRIMARY TREND INDEX (PTI)
3937
Sept. 22
89-Day Moving Average (PTI)
Feb. 2
-1.21
ADVANCE-DECLINE RATIO
-3.92
Nov. 22
SEPT
OCT
NOV
DEC
JAN
FEB

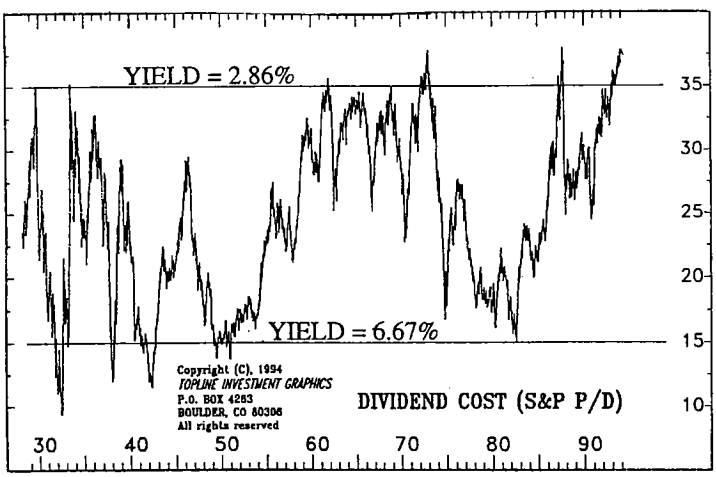
Question: Why are you particularly cautious now?

Answer: I think one chart may provide the answer. You see, the stock market has been facing an increasing problem. The problem is that the market is pushing against 60 years of history.

Ultimately, **VALUES** rule the market. *Over any extended length of time the direction of the stocks is towards values.* And therein lies the problem. On a value basis, the stock market is now stretched as thin as I've ever seen it. The worst part, however, is that nobody seems to be particularly worried. "Overvaluation be damned," says the perma-bull, "hasn't this market been overvalued for two years?" And the answer, "Yes, it has been, but never as overvalued as now." But what's ominous is that people have now grown used to overvaluation. They've ceased seeing overvaluation as a danger signal.

I'm including (bottom of page 2) a chart produced by my old friend, that chart-maven from Colorado, John Carder. What we see here is a graph depicting a multiple or a ratio. The multiple is the S&P 500 times its dividend. Right now the S&P's total dividend is $12.73. That means that at its recent February peak price the S&P was selling at an amazing **37.7** times its dividend.

Historically (check the chart), when the price-times-dividend ratio for the S&P goes over 35, at that point the market has discounted



"the best that it can see ahead." And historically, once the market has discounted the best that it can see ahead -- it has nowhere to go but down.

Currently, the S&P is selling well over the dangerous 35 times dividend. And, that, to my mind, is the single most important problem facing the stock market today. The ratio of "above 35" has acted as a danger signal throughout history. As far as I'm concerned, it still is a danger signal today.

Price Action: On January 31 the Dow closed at a record 3978.36, which was just 32 points away from the fabled 4000 level. Analysts had been "talking 4000 all week," almost as if it was an accomplished fact. Public money continued to pour into the market in massive quantities. On top of that, President Clinton was offered the rare opportunity to appoint not one but two members to the Federal Reserve Board. And the leading indicators of the economy jumped a fat 0.7% for the month.

Low interest rates, better business, an accommodative Fed, was it the best of all worlds? Sounded like it. But remember, once the market has discounted the best of all worlds, there's no way for it to go but down. And in the face of the overvaluation and optimism that has engulfed Wall Street, I have to wonder if we're not awfully close to a turn in the tide.

Question: In recent Letters you wrote about a coming "blow-off" in the stock market, and this prior to any bear market. Have you changed your mind?

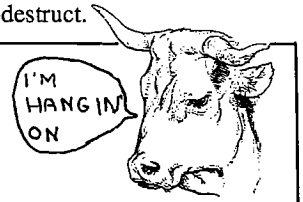
Answer: In this business, you examine and re-examine your thoughts every day. And I'll admit that I'm thinking that we may have seen the blow-off already (even though it was largely centered in the Dow and the Transports). If you look at the page 1 chart of the Averages, you could easily call the recent pattern a "blow-off."

Maybe the market will just consolidate and then move up considerably higher, but at this point this is what bothers me. (1) I don't like the stubborn investor optimism that I see everywhere. (2) I don't like the widespread predictions that the Dow will go over 4000, almost as if it was an accomplished fact. (3) I don't like the way the bonds are acting. And (4) last but not least, I don't like the extreme overvaluation of the S&P 500 as it sells at an almost ridiculous 37.7 times its dividends.

Question: How much credence do you give to the so-called "January barometer"?

Answer: The January barometer states that as January goes for the stock market, so goes the rest of the year. I give this barometer about as much credence as I give to the "Super Bowl indicator." In reality, there's no connection between the stock market and the Super Bowl. By the same token, there's no connection with what stocks are doing in January and what stocks are going to do in say October, November or December. Those of you who have my D-J albums may note that the Dow was up a strong 5.8% during January of 1929 and up 3.25% in January of 1937. Yet both of those years produced historic bear market crashes. The January barometer -- it's like so many other pre-determination devices -- when you need them, darn it, they self-destruct.

INVESTMENT POSITION: Until proved otherwise, (and by that I mean unless or until we can prove that the primary trend has turned bearish), the bull stays in the box.



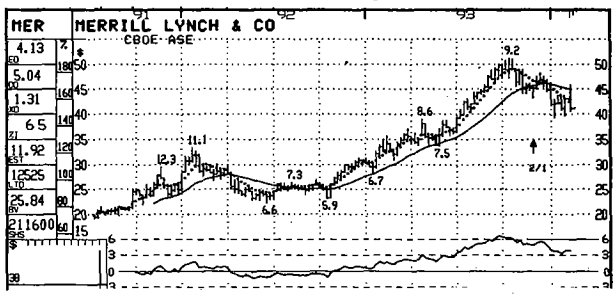
That does not mean that we have to be buying or even holding stocks. When the S&P sells at 37.7 times its dividends, it's time to be super-cautious, which is where I am now. This puts me in the school of "Don't do something, just stand there." I believe it's time to be light, very light in common stocks. Making money from here on is going to be very difficult, with the risk of losing far outweighing the chances of winning.

The big battle in the economy is outlined in detail in the Precious Metals section at the end of this Letter. So sit tight, watch the

markets carefully, and let's see whether the D-J Industrials and Transports can rally to new highs.

A number of subscribers have asked me, "If you had to pick one stock as a barometer of the entire stock market, which one would you use?"

In the old days it was US Steel or General Motors. ("As steel goes, so goes the nation" and "What's good for GM, is good for the nation.") Today, if I had to pick one stock to watch, it would be Merrill Lynch, the nation's largest brokerage house, handling over half a trillion dollars of customers' money. Here's a chart of MER, courtesy of Mansfield. Has Merrill topped out? It's too early to tell, but MER is now well below its 1993 high of 51 1/8. Let's watch it.



PROBABILITIES: In a recent Letter I talked about the very low volatility in the stock market during the years 1991 through 1993. Here's another (and rather fascinating way) of looking at volatility.

Peter Eliades did a study of the Dow going back 61 years to 1933. Peter found that the average maximum Dow decline in any year was 14.5%. He also found that when there are two consecutive years of minor or single-digit declines, the following year invariably produced a greater than average maximum (or greater than 14.5%) decline.

Years in which a greater than 14.5% decline occurred (following two consecutive single-digit decline years) were 1946, 1953, 1960, 1965, 1969, 1987 and 1990.

Now let's bring the study up to the present -- 1991's maximum Dow decline was a mere -6.9%. This was followed by 1992's single-digit decline of -8.1%. On that basis, 1993 should have produced a greater-than 14.5% decline. But wait -- 1993 did the unprecedented -- it produced a third single-digit decline of only -4.1%.

What are the probabilities that 1994 will be the fourth year in a row to produce a single digit decline in the Dow? My feeling -- the odds are not good. Or put it another way, in the market I never like to bet on the unprecedented. Therefore, I'm betting that 1994 will produce a Dow decline of over 14.5%. Four years in a row without a Dow decline of 10% or more implies a market that is incredibly confident and complacent -- and a market that is not ready for surprises.

NOTES & QUOTES: I must have the world's best and kindest subscribers. Hardly a day passes that I don't receive a letter or an enclosure (literature, books, tapes, VCRs) from a subscriber, the letters having to do with health, food, vitamins, etc. Wife Faye says, "It looks as though they want to keep you around." I guess so, therefore, many thanks to all of you out there . . . On Feb. 11 I took chelation (key-lay-shun) session number 14. Do I notice any difference? It may be my imagination, but when I'm on my treadmill (I go 30 minutes a day), I seem to do it with less effort. I also have pushed up the speed, and no problem. Two excellent health letters that many subscribers have recommended are *Second Opinion* [(800) 728-2288] and *Dr. Julian Whitaker's Health & Healing* [(301) 424-3700].

* *

By the way, the death rate from heart trouble among French men is 50% less than American men (French women --37% less than American women). But the French take in more fat than Americans. How to account for the difference? One theory is that the French eat much less sugar than Americans. Some health researchers believe that too much sugar is more deadly than too much fat. The fact is that if we all lived on vegetables, pasta, rice and beans we'd be a lot better off.

* *

Russell opinion on the three greatest dangers in the world today: (1) Russia, where reformers are leaving the government and ex-Communists, ex-KGBs and crazies are taking over. (2) North Korea where "The Great Leader" and his son, "The Dear Leader," are waving nuclear warning flags and building huge troop concentrations on the border with S. Korea. (3) The US stock market, which is dangerously overvalued and loaded to the gills with the public's money via 3,600 assorted mutual funds.

* *

A wall of money has poured into eastern Europe. The *Financial Times* quotes Reginald Duquesnoy, a specialist in eastern European investments, as follows: "I was among the first to land in Poland, and the process I expected to take 10 years happened in nine months. It went from incredibly good value to the most rampant over-valuation I have ever seen."

* *

Once a New Yorker, always a New Yorker? After living in Manhattan for my first 35 years (I was born in the Lenox Hill Hospital in midtown Manhattan), I moved to California. The year was 1961. I've never regretted the move. I left the City in a year when you could still park you car in front of your apartment house overnight without getting it towed away, ticketed or broken into. I think '61 was New York's dividing line between the good -- and the bad and the ugly. Why don't I regret leaving Gotham? Well, without all the aggravation and hassle of living in the City, I'm a New Yorker the easy way. I read about it. I read *Crain's New York*, the *New Yorker, Town & Country*, plus *Vogue, Bazaar* and the rest of the New York oriented magazines. Believe me, I get the full flavor of "Fun City" (remember when they used to call it that) without the problems. What problems? The Jan. 31 issue of *New York* magazine listed a few of the problems on their cover: "Unresponsive cops, car alarms, crazed bicyclists, noxious neighbors, crank calls, towed cars, bad landlords, reckless cabbies, boom-box cars, aggressive beggars, crooked contractors, street rackets, lazy bureaucrats, local porn shops." Of course we have a bit of that here in California, and then there are California's famous four seasons -- fires, floods, earthquakes and drought (and you can add -- riots). California's population increased only 1.4% in '93 over '92, the smallest increase in two decades. Wonder why.

* *

A few words about publications. I'm continually amazed at the sheer mass of information and research (plus good, witty, sophisticated writing) that goes into the *Economist* magazine. How they put out this amazing magazine every week is a mystery to me. Try it -- (800) 456-6086. In the states it's $110 a year, if you're a student it's $75. A second favorite publication of mine is the *International Herald Tribune*. This global-minded daily newspaper is a must, as far as I'm concerned. Every issue is packed with fine articles and information that you don't see elsewhere. Call (800) 882-2884. Price (12 mos.): in NYC it's $357 a year, outside NYC $377. If I only received two newspapers (I now get 12), I'd pick the *NY Times* and the *Int. Herald Tribune*. My third choice would be the *WSJ*, then *Investor's Business Daily*, then the *Christian Science Monitor*, and then the *London Financial Times*, and . . . well, that should hold you for a while.

* *

Bob Prechter just sent me two really fine books on Elliott Wave. One is *"R. N. Elliott's Market Letters."* The other is *"The Complete Elliott Wave Writings of A. Hamilton Bolton."* Bolton was a friend of mine, and I had quite a bit of correspondence with him. In 1962 I was bearish on the stock market while Bolton was bullish. The market suffered a surprising technical collapse (due to Kennedy's stupid confrontation with the steel companies), and Bolton (humble man that he was) wrote me that he was "eating crow." However, Bolton was brilliant and single-handedly revived interest in Elliott. He tied the Wave Theory in with his Bank Credit studies, and the results were always fascinating and amazingly correct. Both books can be purchased from *New Classics Library*, PO Box 1618,

Gainesville, GA 30503. Prechter should be congratulated for publishing these very informative and valuable books.

Speaking of Ham Bolton, he was the founder of the well-known *Bank Credit Analyst,* and he edited that publication for many years. The latest edition of the *BCA* has some interesting things to say: "Great bull markets are founded on easy money, and the current market is no exception. The Fed has worked overtime at the money pump since late-1990, driving real short rates to zero and generating explosive growth in the monetary base. Nevertheless, the current cycle is very different from its predecessors because the surge in central bank liquidity has not translated into a typical expansion of broad money and credit growth . . . The driving force behind the bull market has not been expanding illiquidity but has been an unprecedented portfolio shift of deposits and money market instruments into securities. Indeed, the other side of this shift has been a record deterioration in household liquidity. Deposits as a percent of disposable income have fallen to the lowest level in 30 years . . . An end to the investor stampede out of deposits into securities will have a huge impact on the stock market because mutual funds have become the major source of net demand. Moreover, there does not seem much chance that a more traditional increase in broad-based liquidity will bail out the markets."

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I also received two booklet-pamphlets from my old friend, Jim Blanchard. The first booklet, *"Silver, Striking it Rich With the World's Most Profitable Precious Metal,"* and the second, *"Yellow Fever, How to Profit From the New Bull Market in Gold."* Jim has long been a student of the precious metals, and he does a fine job explaining where we are, what's happening and what may happen. Buy them from *Jefferson Research,* 2400 Jefferson H'way, Jefferson, LA 70121. Mmm, that's a lot of "Jeffersons" in one address.

* *

Along with the epidemic of crime we get the political grandstanders with their half-baked "crowd pleaser" ideas. One idea that has caught on is "three strikes and you're out," which sounds great, but wait. What happens when thousands of these "in prison for life" convicts reach their 70s and 80s, and the cost of holding them including medical runs into $50,000 and $60,000 a year and more? Will we still want to keep these geezers in prison? Will there be enough prisons? Will there be enough money? (Remember, only the federal government can print money, not the states.)

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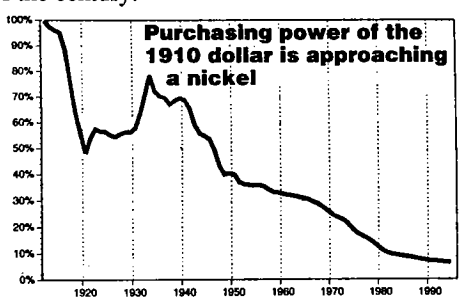
I was struck by this chart from *Pro Farmer* (thanks to R. E. McMasters). It shows the disgraceful collapse in the purchasing power of the dollar. What can one say? It's been US policy since the turn of the century.



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One result of the January Super Bowl, I predict, will be a search for monster offensive linemen. The fact is that Dallas' mammoths simply wore down the Buffalo defensive line. On the Dallas line was Kevin Grogan, 6'7" and 328 pounds, Erik Williams, 6'6" and 324 pounds, and 6'3" Nate Newton at 325 pounds. Laughed Grogan, "Put me, Erik and Nate in front of Emmitt (the running back), and the defense has trouble seeing him. We could have told 'em we were coming, and it wouldn't have made much difference." Super-giant offensive linemen, they're the wave of the future.

* *

I have a lot of ex-Julian Snyder subscribers, and you're probably wondering what Julian is currently saying. In his latest *"Private Letter"* Julian is seriously worried about a third World War featuring Russia. Julian believes that Zhirinovsky is the voice of the KGB, and that all power in Russia is held by the renamed KGB (Federal Counter-Intelligence) and the military. Writes Julian, *"All of which makes the foreign policy of the Clinton administration and the timidity of Europe in the face of Zhirinovsky's threats to launch World War III stupid, ridiculous and dangerous to the lives of all of us. I may be only one voice, but I've got news for the Western world: the cold war isn't over and the eventual hot war is more likely than ever."* So warns Julian (PO Box 70, 7500 St. Moritz, Switzerland). By the way, Julian now recommends "crisis positions" in gold and silver.

* *

From our "Would You Believe?" Dept.: On October 4 President Clinton,to the heads of all government agencies, ordering them to cooperate with requests on the Freedom of Information Act. He wrote, *"Openness in government is essential to accountability, and the Act has become an integral part of that process."* Then came the never-ending struggle to drag out information on Whitewater. That struggle is still going on.

* *

"How's That?": Gus Ornstein was a nationally recognized star football player in high school. He's a Jew. Is that so unusual? Not really, but what is unusual is that Ornstein is going to Notre Dame as the quarterback for the Notre Dame football team. Now that is a first. Said Ornstein, "They said there'd be no problem with a Jewish kid on campus. They made me feel very welcome."

* *

Plants: Did you know that 25% of all prescription drugs used in the US have their origin in plants? There are 250,000 flowering plants in the world, and only 1% have been studied for potential useful drugs. The drug-plant connection remains a treasure trove for the drug industry, and one of the leaders in the drug-plant search is Pfizer. The New York Botanical Garden and Pfizer have a joint project going, a project to research plants for new drugs.

When I was a kid (15 years of age) I used to take the subway up to the NY Botanical Garden in the Bronx. I became absolutely fascinated with cacti. Ed Alexander, the Botanical Garden's taxonomist and an expert on cacti,took me under his wing. In those days the garden had a fabulous collection of cacti, but during World War II the great cactus collection was allowed to disintegrate. The fascination with cacti lasted all my life, and it is still with me today. In the 1930s there were four cactus nurseries in San Diego, and I used to mail order cacti from those nurseries. But I was frustrated trying to grow cacti in a window box in NYC and my boyhood dream was to move to San Diego. In 1961 I made the move. And it all started with my fascination with cacti. I still love 'em.

* *

The Fifth Amendment is no longer a safeguard against the government. The Supreme Court has made it clear that a person accused of committing a crime can be made to turn over all kinds of incriminating evidence such as fingerprints, hair samples, business records, a desk calendar and even the pages of a private diary (as Senator Bob Packwood has found out). The Fifth Amendment actually says *: "No person . . . shall be compelled in any criminal case to be witness against himself."* The Supreme Court has ruled that the amendment does not "serve as a general protector of privacy", but that it only "protects against compelled testimony, not the disclosure of the private information." Thus are our rights under the US Constitution slowly being whittled away. And don't get me started on the Federal Reserve and the dollar.

* *

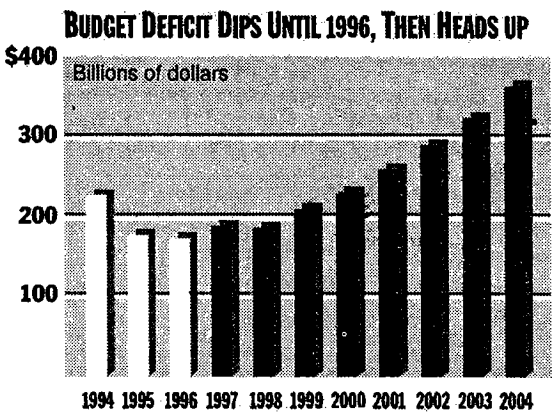
The closer Americans look at Hillary's medical "plan," the less they like it (a recent poll showed only 41% of Americans now favor it, down from a recent 55%). *Newsweek* columnist George Will describes the Clinton plan as follows: "The plan authorizes seven presidential appointees, the National Health Board, to guess the nation's health care needs and decree how much the nation may spend meeting them. Everyone would be locked into one system of low-budget health plans picked by the government. Fifteen presidential appointees, the National Quality Management Council, not you and your doctor, would define the 'medically necessary' and 'appropriate' care a doctor could give you. Escaping government control to choose your doctor or buy other care would

be virtually impossible. Doctors would be paid only by the government-approved plans, at rates set by the government. It would be illegal for doctors to accept money directly from patients, and there would be 15-year jail terms for people driven to bribery for care they feel they need but the government does not deem 'necessary'." Russell comment: This is the plan that Hillary and the "secretive 500" have come up with. Clinton claims it will save $58 billion over six years. The Congressional Budget Office claims it will push the deficit up around $78 billion over six years. Switzerland, anyone?

A shocker to the Clintonites: the prestigious Business Roundtable (200 top business leaders) have come out against the Clinton health plan. At the same time, the US Chamber of Commerce warned against even using the Clinton plan as a "starting point." The Russell opinion: The Clinton health plan is fading, fading. It's too expensive, too bureaucratic, too complicated, and almost guaranteed to produce inferior medical care. The only people who love the plan are Bill and Hillary.

* *

Why so little excitement about the new Clinton Budget? Two reasons -- first, Presidential budgets in recent years have become less important, simply because Congress takes them apart, argues, compromises, and re-shapes them to Congress' liking. But with a Democrat President, this could conceivably change. Second reason -- there was nothing exciting in the Clinton budget. Most of it was switching around, moving money out of various programs and into programs that Clinton favors. But for a $1.5 trillion budget there wasn't very much in the way of actual spending cuts. Writes Paul Gigot of the *WSJ*, "Bill Clinton's Washington has just produced its own miracle -- an honest liberal." He's Robert Reischauer, head of the Congressional Budget Office (which is controlled by the Democrats). This chart shows what the Congressional Budget Office sees ahead for the deficits, namely a dip through 1996 -- and then the deficits head higher again.



SOURCE: Congressional Budget Office

Veteran readers of these Letters learned long ago not to take the government's inflation statistics seriously. Maybe there should be two indices -- one entitled, "The US Government's Fantasy Inflation Index," and the other, "The True Cost-of-Living Index." As you know, the government's Consumer Price Index rose last year at the phoney rate of 2.7%. I'm presenting the following few items for the True Cost-of-Living Index: Two weeks ago Ford announced that it is raising prices on its 1994 models and reducing rebates (this was the second raise for the new '94 models). Last month GM announced its second price boost on the '94 models. Chrysler last summer estimated that '94 prices would be 1.2% higher on their models, then boosted that to 1.9% when the company announced its '94 prices . . . The Labor Dept. last week announced that medical costs in the US rose 5.4% in 1993 over '92 Ever wonder why the government doesn't include taxes in the cost-of-living statistics. Answer: it would be too embarrassing.

AVOIDANCE: One of the reasons politicians take to inflation is that it avoids the pain of deflation. You see, deflation is super-painful and can lead to depression. So inflation really isn't so bad. And if inflation is allowed to simmer slowly, then people may not even notice it -- or at worst they may complain but nevertheless accept it. It's much like the frog in the pot of water. Drop a frog in a pot of hot water, and he'll instantly leap out. But put the frog in a pot of warm water and heat that water slowly to the boiling point, the frog will sit there and die a par-boiled death -- and never know what happened to him.

Last night I read a piece written by the great Gesalt psychiatrist, Frederick (Fritz) Perls. What Perls said struck me as so important that I wanted to repeat it. Here goes: "In the previous decades, the man of society lived for what is right, and he did his job, never mind whether he really wanted the job or whether he was suited for it. But the whole society was ruled and regulated by 'shouldisms' and by puritanism. You did your thing whether you liked it or not.

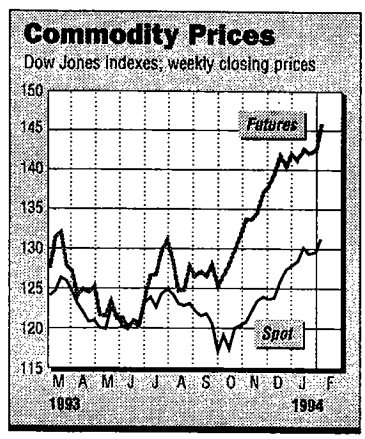
"Now I believe the whole social milieu has changed. Puritanism has changed into hedonism. We begin to live for fun, enjoyment, for being turned on. Anything goes as long as it's nice. And that sounds good too. It sounds superior to moralism. It is, however, a very serious setback. The setback is that we have become *phobic* towards pain and suffering.

"Anything that is not fun or pleasant is to be avoided. So we run away from any frustration that might be painful, and we try to short-cut it. The result is lack of growth. In talking about avoiding pain, I'm talking about avoiding the suffering that goes along with growing up. I'm talking about avoiding any unpleasant situations."

Fritz died about 10 years ago. Ah, Fritz, if you could only see the world today. The young men don't want to go through the suffering of learning to do a job, of making a living. It's a lot easier to grab a Colt 45 and mug someone. As far as marriage, well if there are any problems, simply file for divorce, and if your kids suffer, well, they'll get over it. Or if getting divorced is too expensive or too much trouble, well just help yourself to a little extra-marital fun, and who'll be the wiser? Teenage girls hate their home life? No problem, have a baby and go on welfare, gosh, that's what a lot of your friends do. As for responsibilities, who needs 'em, what you're really interested in is entitlements, and the more of them that Uncle Sam dishes out, the better.

Yep, it's the new world of fun, fun, fun, and avoidance of pain. In the financial world, we call avoidance of pain -- inflation. Talk about the national debt got you down, Mr. Politician? Well, heck man, just let the Fed do its job, let 'em pump up the money supply and knock those interest rates down. And if that doesn't do the trick, you can borrow $60 billion or so from the Social Security trust fund. And if all that nonsense and manipulation generates a little inflation, so be it. At worst, home prices will go up, and you know something -- there are a hell of a lot of American home-owners who would go for that, big time.

PRECIOUS METALS: The Fed has been watching this chart; the Fed has also been watching gold. The two charts, taken together with January's explosive stock market action, provided the fuel for the recent blip-up in short-term interest rates.



But wait a minute -- there's more. The Fed really wants two things: it wants short rates below 4% and it wants gold below 400. You don't believe it? Listen to this from the *D-J Retrieval Service* (Feb. 5): "In their (the Fed's) judgment, economic and financial conditions were unlikely to be more favorable later and waiting risked undesirable

inflationary consequences. Fed governor Angell also stressed that the committee should focus more directly on forward-looking indicators such as the price of gold . . . He favored an immediate increase of 50 basis points in the Fed Funds rate, which would enable the committee to observe how the market adjusted the price of gold to the changed opportunity cost of holding gold."

In other words, in the actual words of a Fed governor -- gold is the real barometer. If gold goes up, then the Fed should raise interest rates so that the penalty for holding gold (since gold pays no interest) becomes more costly to the gold-holder.

There you have it. In effect, Angell is saying forget about the government's lagging and deceptive statistics on inflation, the true barometer of inflation is the price of gold. Thus, the Fed is the sworn enemy of gold. Gold's price must be held down.

Now it is extremely important that you understand the following: Clinton has imposed a huge retroactive tax on the real spenders of America. Interest rates are also creeping higher. Furthermore, Clinton is drastically shrinking the nation's defense establishment. And our President is also claiming that he's reducing the deficit. Now consider this: if the US economy is sluggishly moving along with the help of synthetically low interest rates and a billion dollars a day in stimulative federal deficits, what will happen if the deficits are cut and all the above changes kick in?

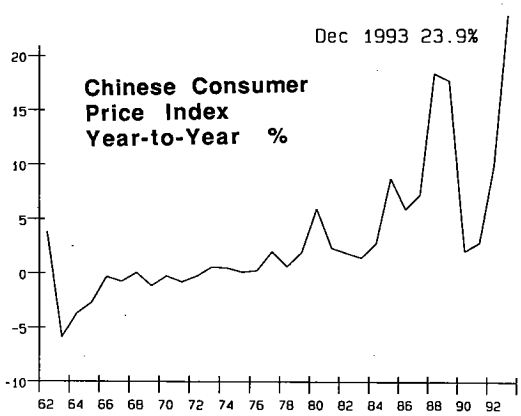
One thing that could happen is that we could have a renewed slump in '94. If the economy slumps, the onus will fall on US monetary policy to try to turn the economy around. Which means that the pressure will be on the Fed to reduce rates again while continuing to pump up the money supply. Both conditions would be highly advantageous for gold.

What I'm trying to show is that the US government is directly opposed to a rising price for gold. But ironically, the government faces a severe economic dilemma -- if gold is held down via higher rates, this puts the squeeze on the economy. But if gold is allowed to rise, then the Fed has lost the inflation battle.

So who will win? In the end, gold will win. The Fed and the administration will undoubtedly accept rising inflation rather than unemployment and recession. Of course, there is another possibility. We could have perpetual prosperity with little or no inflation. But my advice is -- don't bet on it.

On another subject, I've never been a big fan of silver, which is probably a stupid prejudice on my part. But Jim Blanchard in his new book on silver (see announcement of the book in Notes & Quotes) makes a heck of a case for the metal. Jim points to the very favorable supply/demand situation in silver, the rising industrial demand, the "coming re-monetization of silver," and the fact that the gold/silver ratio is still historically high -- but it's moving in favor of silver over gold.

One problem with silver is that there are no pure silver stock plays. So unless you're willing to buy silver coins or bars or silver futures, it's a bit difficult to play the silver game. Some silver producers are TVX on the Nasdaq and Echo Bay, Coeur d'Alene and Hecla on the NYSE.



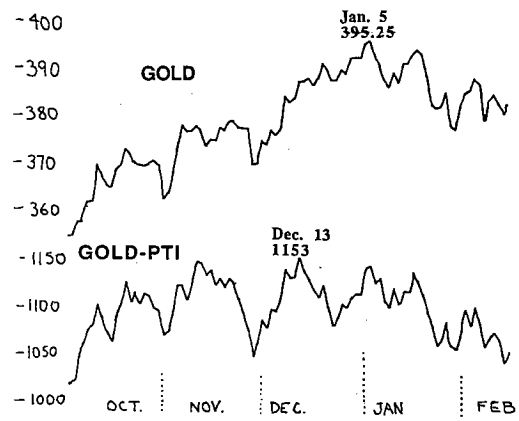
Here's a chart that I feel has great significance for the precious metals. It shows Chinese inflation, which is now running at a rate of well over 20%. The Chinese government has evidently decided that rapid growth is what's important, and if rapid growth foments inflation, then so be it. But the Chinese savings rate is reputed to be around 30%, and the Chinese are (1) very gold-minded, and (2) very worried about inflation. Therefore, I expect China (and all of Asia, for that matter) to be consistent big buyers of the precious metals in the months and years to come (chart courtesy of Ed Hyman and *ISI*).

A lot of subscribers have asked, "Russell, what happens to gold stocks if Wall Street goes into a bear market?" Obviously, there can be no certainty about this, but if we have a primary bear market (and it would almost surely be international in scope) we'd see the central banks of the world move to fight the bear market with every tool at their command. Their number one tool, of course, would be monetary, which means that they would make credit as accommodating as possible, this along with pumping up the money supplies in any way they could. In other words, they would try to inflate themselves out of economic contraction and depression.

All this would presumably be a plus for gold. Furthermore, in the event of a bear market there would be a great fear that the world's debt structures would topple. Since the US national debt, now approaching $5 trillion, is supported by a huge inflow of dollars (used to finance the ever-growing debt), you have to ask yourself, "What would happen if the inflow of dollars slowed drastically?"

The answer could well be a questioning of the credit-worthiness of the US and therefore of the dollar. And if that occurred, gold would be the only true island of safety. Gold would then be the only "money" that was not someone else's liability, and liabilities in a bear market are another name for trouble. Paper created by the world's central banks could come under severe suspicion, and we could see the spectacle of gold rising while the rest of the world heads into depression.

On Jan. 5 gold hit a high of 395.25, producing an upside non-confirmation, since the Gold-PTI, hit its high two weeks earlier. A decline followed. Last week the G-PTI broke below its Nov. low, but this time there was a downside non-confirmation which appeared when gold refused to break below its own November low. The total gold picture -- a stand-off, but my thought is that the gold shares have probably moved too far ahead of gold.



LATE NOTES: Is the US facing a trade war with Japan? I doubt it. The last thing either country wants is a trade war. Russell guess: Japanese will ease a bit on allowing US sales to Japan -- Clinton will go for it (compromise as usual) and things will calm down. Meanwhile, the dollar turns weak as yen surges and other currencies strengthen. My Low Risk Indices on yen, Swiss and D-mark have all turned up . . . No use trying to out-guess the US stock market or the economy here. It's time to watch and wait. Big bull markets build tremendous upside momentum, and they don't die easy. This bull market is no exception. What about the 96 point Dow drop of January 4? The public has been conditioned to buy all declines. Will they be right? We'll see.

NEXT MAILING: March 2, 1994